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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

October Term, 1951

No. 689

In the Matter

—*of*—

THE DAUNT CORPORATION,

Bankrupt.

LOUIS S. WEINER,

Petitioner,

—against—

RECONSTRUCTION FINANCE CORPORATION,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

I. H. WACHTEL,
Attorney for Petitioner,
917 15th Street, N.W.,
Washington, D. C.

HARRY A. MARGOLIS and
JULIUS J. ABESON,
Of New York City.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Louis S. Weiner, as trustee in bankruptcy of the Daunt Corporation, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above entitled case on November 7, 1951.

Opinions Below

The memorandum opinion of the referee in bankruptcy (R. 154-170) is not reported. The District Court rendered

no opinion. The opinion of the Court of Appeals (R.) is reported in 192 F. 2nd 760.

Jurisdiction

The judgment of the Court of Appeals was entered November 7, 1951. By order of Mr. Justice Jackson, dated February 4, 1952, the time to file this petition for certiorari was extended to April 5, 1952. The jurisdiction of this Court is invoked under Title 11, United States Code, Section 47(c) and Title 28, United States Code, Section (1).

Statutes Involved

The pertinent statutory provisions are printed in the Appendix to this petition, *infra*, pp.

Questions Presented

(a) Whether a chattel mortgage on property located in New York, executed and filed in accordance with New York statute, and there valid as against third parties, is valid as against the mortgagor's trustee in bankruptcy, after the property had been removed to New Jersey, with the mortgagee's knowledge and consent, the New York mortgage not having been recorded in New Jersey, in any form, and New Jersey having no statute providing for recordation of a foreign chattel mortgage?

(b) Whether the Court below correctly found and applied the applicable New Jersey law?

(c) Whether sound policy and the equities of the situation require that the New York mortgagee prevail over the mortgagor's trustee in bankruptcy, in the circumstances

above stated in (a), where the trustee represents creditors who extended credit to the mortgagor in New Jersey.

Statement

In April, 1946, The Daunt Corporation (hereinafter referred to as Daunt), manufacturer of lighting equipment and having its office and principal place of business in New York, gave to Reconstruction Finance Corporation (hereinafter referred to as RFC) a chattel mortgage on all of its equipment and other personal property in New York. This chattel mortgage was duly filed in accordance with New York laws (R. 56, 57; 95, 96). Thereafter, in 1946 and 1947, Daunt gave to RFC supplemental mortgages on newly acquired equipment and other personalty. These mortgages were also duly filed pursuant to New York laws (R. 57-59; 96-98).

In March, 1948, Daunt acquired from RFC land and buildings in New Jersey and between May 15, 1948, and September 1, 1948, it moved from New York into these buildings its office, place of business and all the personal property then covered by the aforementioned original and supplemental RFC mortgages executed and filed in New York. This removal from New York to New Jersey was made with RFC's knowledge and consent (R. 60, 61; 99, 100).

The New York mortgages were never recorded in New Jersey, in any form. However, on November 22, 1948, Daunt gave to RFC a supplemental chattel mortgage upon all of its personalty then located in New Jersey, after its removal from New York, and which was covered by the New York mortgages. This supplemental mortgage was duly recorded in New Jersey on November 22, 1948 (R. 62, 101).

During the period from May 15, 1948, when Daunt began moving, from New York to New Jersey, its property which was subject to the New York mortgages, to November 22, 1948, when the New Jersey mortgage was executed and filed, Daunt incurred debts and obligations which were and remained unpaid at the time of the institution of the instant proceeding and for which claims had been filed therein (R. 79-81; 130-132).

November 24, 1948, Daunt filed in the United States District Court for the Southern District of New York a petition for arrangement under Chapter XI of the Bankruptcy Act. As debtor-in-possession, it continued operation of its business until June 15, 1949, when, in default of filing a required indemnity bond, it was adjudicated bankrupt. Petitioner was appointed receiver (R. 53, 54) and later, trustee of the bankrupt estate (R. 92, 93).

By petition and order to show cause, petitioner brought two successive proceedings before the referee for the annulment of the New York chattel mortgages upon Daunt's property which had been removed from New York to New Jersey with RFC's knowledge and consent, and which had been in New Jersey at the time of the filing of Daunt's petition for arrangement (R. 46-70; 85-119). RFC filed answers to the petitions denying material allegations, admitting others and pleading affirmative defenses that the petitions fail to state claims upon which relief can be granted (R. 73-78, 82-83; 121-129, 133-134). In consonance with its affirmative defenses, RFC made application for the dismissal of the petitions for insufficiency to state valid claims. The two proceedings were submitted together, on the pleadings, the facts alleged in the petitions, and as above in part recited, being admitted for that purpose (R. 154, 155, 143).

The referee held that: the law of New Jersey applies, but the precise question in issue has not been passed upon by a New Jersey court (R. 165); in the majority of other states the courts have held that a mortgage lien on chattels removed from one state to another with the knowledge and consent of the mortgagee is not enforceable in the second state against the mortgagor's innocent purchasers, encumbrancers or judgment creditors (R. 165, 166); this rule is to be distinguished from a contra minority rule, where the mortgaged chattels are moved to the second state without the mortgagee's knowledge or consent (R. 168); the equities of the situation are against the mortgagee who permits removal of the chattels into the second state, to the injury of innocent parties there (R. 167, 168). So holding, the referee denied RFC's application to dismiss the petitions, as a matter of law, dismissed its affirmative defenses (R. 169) and made an order to that effect (R. 172-182). On RFC's petition for review of the referee's order (R. 184-194), the District Court affirmed without opinion and made an order of affirmance (R. 202-212).

On appeal, the Court of Appeals reversed the order of the District Court and directed dismissal of the petitions (R.). It denied the existence of the majority rule mentioned by the referee, denied that the equities of the situation are as the referee found and held that: the mortgagee's interest is divested, after removal of the chattel with his consent, by an attachment or execution of the mortgagor's creditor, only if a statute of the second state so provides; there is no statute in New Jersey which provides for recording of or which invalidates foreign chattel mortgages and New Jersey cases express a policy favoring recognition of foreign chattel mortgages as against New Jersey purchasers and creditors (R.); courts of other states are in accord with this New Jersey policy (R.).

Specification of Errors

The Court of Appeals erred:

1. In holding that a chattel mortgage lien, valid in the state where the mortgaged property was originally located, will lose its priority over attaching creditors in another state to which the property is removed with the mortgagee's knowledge and consent, only if a statute of the other state so provides.

2. In accepting as controlling New Jersey cases not decided by the highest court of that state and which, in any event, do not expressly pass upon the question whether the fact of the mortgagee's consent to the removal of the chattels into New Jersey is material to the issue of recognition of the New York mortgages as against the mortgagor's attaching creditors.

3. In refusing to follow and adopt the policy of a large number of decisions in courts other than New Jersey refusing recognition of foreign chattel mortgages, as against local attaching creditors and other third parties dealing with the mortgagor, where the mortaged property is removed with the knowledge and consent of the mortgagee, irrespective of the non-existence in the second state of a statute providing for recording of or invalidating foreign mortgages.

Reasons for Granting the Writ

1. The questions involved in this case are of vital importance to Government Agencies and private financial institutions lending capital to industrial enterprises on the

security of chattel mortgages which cover machinery, equipment, motor vehicles and a vast variety of other instruments of modern manufacture, commerce and business, as well as consumer goods. The removal of such mortgaged property from one state to another is a common practice, particularly where the two states are adjoining, as are New York and New Jersey. Free and unhindered removal from one state to another is undoubtedly of benefit to lender and borrower alike. Free and unhindered removal, without due regard for the interests of third parties dealing with the borrower in the second state without knowledge of the liens of foreign mortgages, is definitely an evil. The desired protection of lenders' security clashes with the traditionally abhorrent secret lien. Such conflict of interests should be resolved and the pertinent rights and duties defined whenever occasion arises, particularly where the federal rights of a trustee in bankruptcy intervene, he having a status of an attaching creditor (11 U. S. C., Sect. 110(c), Appendix), and where an authoritative definition of rights and duties becomes important to the administration of bankrupt estates. The Court of Appeals recognized the importance of the case and of the questions presented for decision by granting leave to C. I. T. Financial Corporation, one of the larger financial institutions in the country, to file a brief as *amicus curiae*. The questions presented for decision here are very likely to arise with frequency and while this Court cannot settle the applicable law for the entire country, a definitive pronouncement of the pertinent rules of conflict of laws, as between New York and New Jersey, is urgently needed and desired.

2. The decision of the court below is believed to be erroneous. New Jersey law concededly governing, the Court of Appeals cited four New Jersey cases. *Parr* v. *Brady*, 37 N. J. L. 201; *Mygirack* v. *Lepore*, 6 N. J. Super.

505, 69 A. 2nd 772; *Marvin Safe Co.* v. *Norton,* 48 N. J. L. 410, 7 A. 418; *Lane* v. *J. E. Roach's Banda Mexicana Co.,* 78 N. J. Eq. 439, 79 A. 365. None of these are decisions of the highest court of New Jersey and for this reason they do not settle New Jersey law and policy for the Federal courts in New York. Neither do they furnish conclusive basis upon which the Federal courts may surmise, were surmise proper, what the highest court of New Jersey would say New Jersey law and policy are. In none of these cases did the court consider and expressly pass upon the question whether the fact of the mortgagee's consent to the removal would be decisive of or have a bearing upon recognition of a chattel mortgage executed and valid in the original state. In *Parr* v. *Brady,* the removal was without the mortgagee's consent. In *Mygirack* v. *Lepore,* there is no indication whether the removal was with the mortgagee's consent. In *Lane* v. *J. E. Roache's etc.,* only a transitory, not permanent, removal was contemplated by the mortgagee, but such a removal does not bar recognition of the foreign mortgage. *Bankers' Finance Corp.* v. *Locke etc.,* 170 Tenn. 28, 91 S. W. 2nd 297, 299.

In the absence of controlling New Jersey authority, which the court below evidently recognized, the court was free, if indeed it was not required, to state expressly what it considered to be sound policy and the equities of the situation. This it did not do. It quoted with approval *Goodrich on Conflict of Laws,* where no New Jersey cases are cited (R.), and the American Law Institute's *Restatement of Conflict of Laws* (R.). These opinions, to be sure, deserve consideration but their weight should be measured only by the extent to which court decisions support them. And the Court of Appeals did cite five cases from states other than New Jersey. These, however, do not furnish any conclusive support either to

the text, the Restatement, or the decision. Thus, *Smith* v. *Brooks*, 47 N. W. 2nd 389, 154 Neb. 93, accorded a Kansas mortgage priority over the lien of an attaching creditor in Nebraska only because the attaching creditor was a resident of Kansas, where he entered into the contract which gave rise to the later attachment, and he had constructive notice of the chattel mortgage filed in Kansas, prior to the removal of the res into Nebraska. Furthermore, the mortgagee's consent to the removal was limited to and conditioned upon the sale of the mortgaged res in Nebraska by the mortgagor, the proceeds to be remitted to the mortgagee, the mortgagor acting as agent for the mortgagee. Neither of these two distinguishing factors are present in the case at bar and a proper reading of the opinion will show that Nebraska does not repudiate the general rule of refusing to recognize a foreign chattel mortgage upon removal of the res into Nebraska with the mortgagee's knowledge and consent. *Goetschius* v. *Brighton*, 245 N. Y. 186, 192, 156 N. E. 660, leaves open the question here in issue and in *Farnham* v. *Eichler*, 230 App. Div. 639, 246 N. Y. S. 133, it does not clearly appear that the removal was with the consent of the mortgagee. New York law is altogether unsettled and the two New York cases cannot be said to support the judgment below. See *New York Annotations to Restatement of Conflict of Laws*, Sections 268-275. *Shapard* v. *Hynes*, 8 Cir., 104 F. 449, 52 L. R. A. 675, applying Indian Territory law to recognize the priority of a Texas mortgage over a local attaching creditor, appears to support the judgment below but, as pointed out by the Delaware Court in *Morris Plan Bank etc.* v. *Terrell*, 69 A. 2nd 452, 453, "it is one of the few cases which extends the result to cases where the first mortgagee either knew of or consented to the removal." The result in *Cobb* v. *Buswell* (1864), 37 Vt. 337, also appears to sustain the judgment

below, but who can say with any assurance that the Vermont court of last resort today would follow a decision rendered during the Civil War?—and even if it would, the removal in the *Cobb* case, with the mortgagee's consent, from New Hampshire to Vermont, was not a permanent removal, an operative fact requiring recognition of the foreign mortgage even in Tennessee where prevails the majority rule referred to by the referee. *Bankers' Finance Corp.* v. *Locke etc.*, 170 Tenn. 28, 91 S. W. 2nd 297, 299.

Opposed to these inconclusive decisions of courts from states other than New Jersey are many cases, in addition to those cited by the referee (R. 166, 167), holding, upon sound reason and generally entrenched policy against secret liens, that where mortgaged chattels are removed from the original to a second state, with the knowledge and consent of the mortgagee, the mortgage lien is not given priority and recognition over the mortgagor's innocent purchasers and attaching creditors, even though in the second state there is no statute for recording of or invalidating foreign mortgages. *Hess-Harrington, Inc.* v. *State Exchange Bank etc.* (Sup. Ct., Kansas), 122 P. 2nd 739; *Hart* v. *Oliver Farm Equipment Sales Co.* (Sup. Ct., N. M.), 21 P. 2nd 96; *Morris Plan Bank etc.* v. *Terrell* (Superior Ct., Del.), 62 A. 2nd 452; *Bank of Atlanta* v. *Fretz*, 148 Tex. 551, 226 S. W. 2nd 843; *United Construction Co.* v. *Milam* (C. C. A. 6), 124 F. 2nd 670; *Robbins* v. *Bostian* (C. C. A. 8), 138 F. 2nd 622; *Bankers' Finance Corp.* v. *Locke etc.*, 170 Tenn. 28, 91 S. W. 2nd 297; *Bank of California* v. *American Fruit Growers, Inc.* (D. C. Wash.), 41 F. Supp. 967.

3. Clearly the decision below is in conflict with all the foregoing cases, including the two cases from the Sixth and Eighth Circuits, on the issue of policy and equities of the situation. There is no question but that there is con-

siderable difference of opinion and much confusion in the cases as to what the policy and equities of the situation should be where comity and desired protection of valid liens, as an encouragement to financing, conflict with innocent third parties dealing with the mortgagor in the second state, ignorant of the secret liens upon the mortgagor's property. New Jersey is not alone in absence of authoritative decisions by the highest court of the state. As heretofore pointed out, New York law is entirely unsettled. There is a real and substantial necessity for the settlement by this Court of what it conceives to be the better policy and equities of the situation, for adoption by lower Federal courts in proper cases and for guidance to state courts in this important field of the conflict of laws.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

April 3, 1952.

Respectfully submitted,

I. H. WACHTEL,
Counsel for Petitioner.

APPENDIX

Statutes Involved

Title 11, United States Code, Section 110(c), as amended March 18, 1950.

> "* * * The trustee, as to all property of the bankrupt at the date of bankruptcy whether or not coming into possession or control of the court, shall be deemed vested as of the date of bankruptcy with all the rights, remedies and powers of a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor actually exists."

New Jersey Revised Statutes, Title 46, Chapter 28, Section 5.

> "Every mortgage or conveyance intended to operate as a mortgage of goods and chattels, which shall not be accompanied by an immediate delivery and be followed by an actual and continued change of possession of the things mortgaged, shall be absolutely void as against the creditors of the mortgagor, and as against subsequent purchasers and mortgagees in good faith, unless the mortgage, having annexed thereto an affidavit or affirmation, made and subscribed by the holder of such mortgage, his agent or attorney, stating the consideration of such mortgage and, as nearly as possible, the amount due and to become due thereon, be recorded by section 46:28—7 of this title."

New Jersey Revised Statutes, Title 46, Chapter 28, Section 7.

> "Every instrument mentioned in section 46:28-5 of this title shall be recorded, in suitable books provided for that purpose, in the office of the county recording officer of the county where the property so mortgaged shall be at the time of the execution of such instrument; * * *."

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